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STERLING

RESOURCES LTD.

ANNUAL REPORT



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ANNOUNCEMENT GENERAL MEETING

The Annual General Meeting of the Company will be held on Tuesday, May 5, 1998, at 10:00 a.m. at the Cardinal Room at the Calgary Convention Club, 319 - 5th Avenue S.W., Calgary, Alberta.

CORPORATE PROFILE

Sterling Resources Ltd. is a Calgary based, publicly traded, energy company engaged in the exploration, development and production of crude oil and natural gas in selected countries of the world.

The Company was incorporated in 1979 as Peoples Oil Limited and its activities were conducted primarily in Western Canada and the U.S.A. A group of new investors, with extensive international and domestic experience, acquired control of the Company in May, 1996. A new strategy for growth by means of international exploration and exploitation was adopted and a change of name to Sterling Resources Ltd. took effect in February, 1997.

Sterling's major growth will come from international projects which have potential for large, low-cost reserves of oil and gas, and acceptable economic terms, political risk and marketing conditions. Sterling will concentrate on the sourcing and initiating of such projects. Partners will be brought in to share the risks and to permit Sterling to manage its desired level of financial exposure. The Company's existing Canadian asset base is being used to provide cash flow to fund the initial stages of its international strategy.

During 1997 Sterling acquired its first international play: two exploration blocks in the Romanian Black Sea. In early 1998 the Company was awarded three exploration blocks in the Wessex Basin in southern England and is evaluating other petroleum opportunities in Western Europe, the Middle East, and North Africa.

The shares of Sterling Resources Ltd. are listed on the Alberta Stock Exchange and trade under the symbol "SLG".

HIGHLIGHTS

	12 Months Dec 31/97	12 Months Oct 31/96	% Change
FINANCIAL			
Revenue	\$ 338,097	\$ 46,767	623
Net Income (loss)	\$ (304,509)	\$ (403,743)	25
Cash Flow from Operations	\$ 24,039	\$ (236,441)	110
Capital Expenditures	\$ 4,175,710	\$ 123,335	3,286
OPERATING			
Production			
Crude Oil and NGL (bbl)	1,860	951	96
Natural Gas (Mcf)	176,550	18,030	879
Average Prices			
Crude Oil (\$/bbl)	26.75	18.99	41
Natural Gas (\$/Mcf)	1.54	1.67	(8)
Reserves (proven)			
Crude Oil and NGL (Mbbbl)	24.1	3.8	534
Natural Gas (MMcf)	2,513.8	173.2	1,351

MESSAGE TO SHAREHOLDERS

Sterling is making good progress in implementing its new growth strategy. This strategy, adopted at the beginning of 1997, aims to achieve substantial growth through international exploration and exploitation. The existing Canadian asset base is being exploited fully to provide cash flow to fund the costs of entering international areas.

In Canada, we increased production from minimal amounts to a productive capacity of 2.5 MMcf/d at year-end by drilling on our existing acreage. This will put Sterling in a positive cash flow position in 1998.

Sterling entered its first international venture in 1997: a 10% working interest in a high potential exploration play offshore Romania that contained a significant gas discovery. Three wells were drilled to complete the work commitment on the Exploration and Production Sharing Agreement (EPSA), with two encountering non-commercial volumes of natural gas. The EPSA consists of two blocks that now cover approximately 1.1 million acres and contain additional prospects and leads. Plans are to extend the license through 1998.

Also, Sterling was recently awarded three blocks onshore United Kingdom as part of the 8th Round of licensing. The blocks are located in southern England in proximity to and on trend with Wytch Farm, Western Europe's largest onshore oilfield. Sterling's interest is 45%.

Internationally, a period of time is required for prospect assembly once a strategy of international exploration and exploitation is adopted. International prospects by their nature take longer to consummate and Sterling is being selective in the quality of the projects it is seeking. Several are currently under review and we are confident that additional projects will be acquired in the coming year. Sterling's international efforts will be concentrated in selected areas of Europe, North Africa, and the Middle East.

To accelerate international activity, Mr. R.G. Welty assumed the position of Chief Executive Officer effective January 1, 1998 and he will be devoting his time primarily to obtaining new international ventures for Sterling.

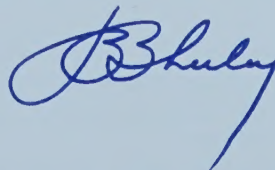
Sterling is in an excellent position to provide appreciable growth. We have a management team experienced in sourcing international ventures. We have a good financial position with positive working capital, positive cash flow and no debt, and our relatively small number of shares outstanding should cause our successes to be reflected more directly in shareholder value.

We look forward to 1998 as an exciting year for Sterling.

On behalf of the Board of Directors



R. G. Welty
Chairman and C.E.O.
March 12, 1998

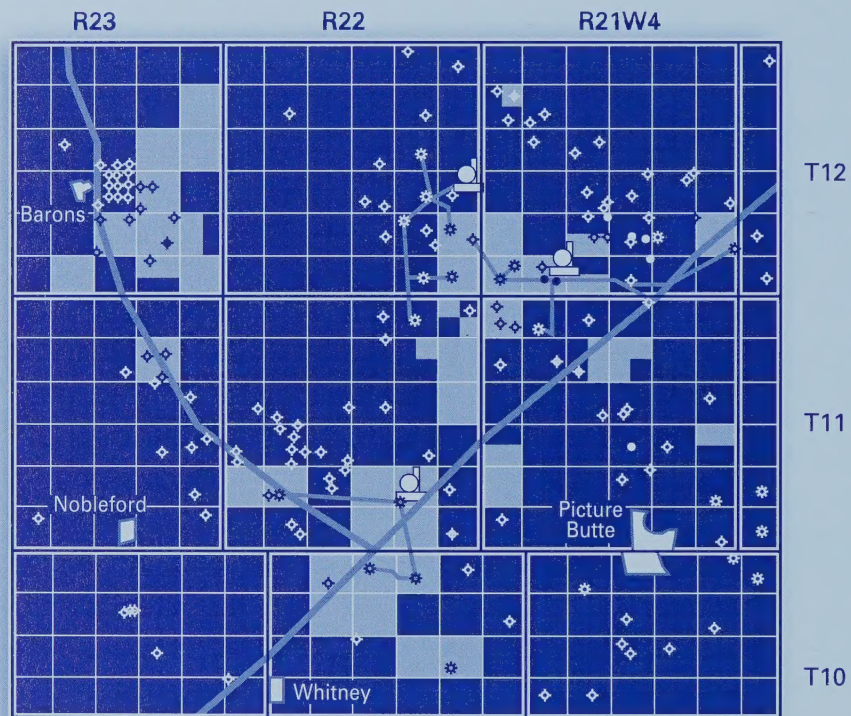


B. W. Sherley
President

OPERATIONS AND FINANCIAL REVIEW

In Canada, two successful gas wells were drilled in the Keho area of southern Alberta on 100% owned lands. The 12-12 well went on stream in mid-August at 1.2 MMcf/d plus 8 bbl/d of condensate, thus contributing for four and a half months to 1997 production. A second well at 4-1 was drilled and completed in November, then placed on stream in early January of 1998 at a similar rate. The full impact of both wells will be realized in 1998. Also, long outstanding operational issues with a local operator were resolved satisfactorily. We will continue to optimize our existing Canadian asset base and increase cash flow through drilling, workovers, farmouts and property sales.

Keho Area, Southern Alberta



COMPANY LANDS

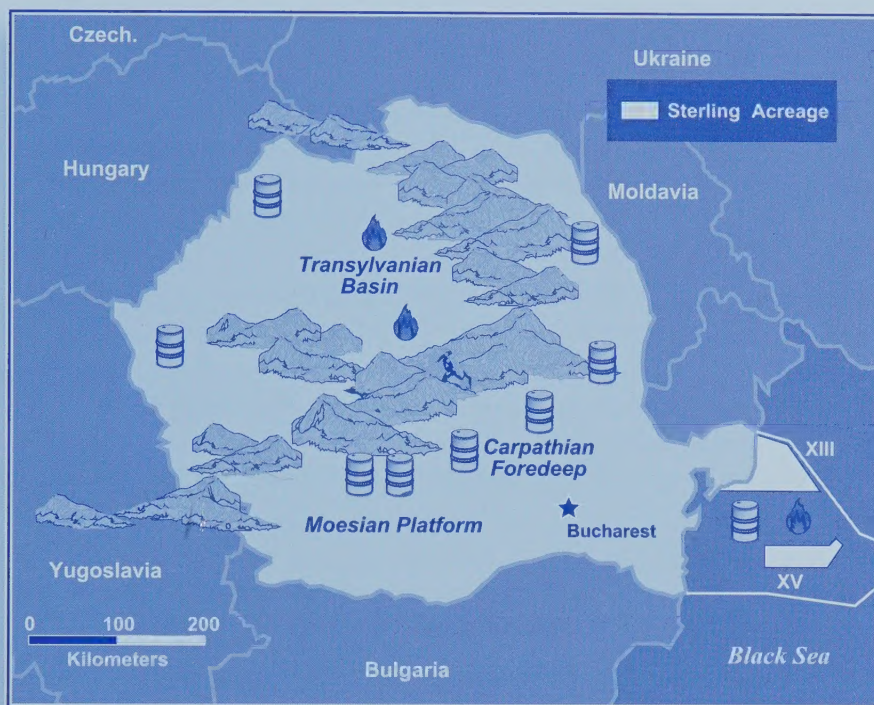
GAS PLANT

- * GAS WELL
- OIL WELL
- ◆ ABANDONED WELL
- ✦ SUSPENDED WELL



Internationally, Sterling's first venture was the acquisition of a 10% interest in an Exploration and Production Sharing Agreement (EPSA) in the Black Sea offshore Romania consisting of two separate blocks containing 1.7 million acres. A gas discovery had been made prior to Sterling's entry into the joint venture. The two blocks are close to shore where a local gas market and infrastructure exist and prices are favorable.

Romania Overview



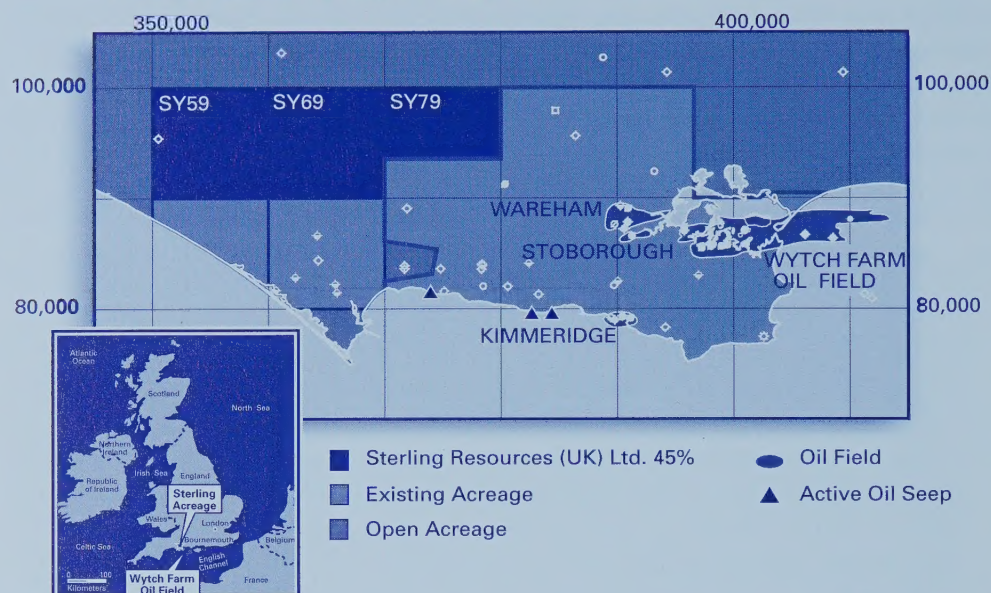
To minimize financial exposure, Sterling farmed out half of its interest. Three exploration wells were drilled during 1997 to complete the commitment on the EPSA, with two discovering non-commercial gas.

ARCO, the operator and a world leader in AVO seismic analysis, integrated data from the discovery well and these new wells into their seismic model. Partners are encouraged by the results of this work and have applied for an extension to the term of the EPSA. A partial relinquishment of land was required, and the EPSA now comprises approximately 1.1 million acres. Sterling recently increased its working interest to 16.67%.

The new seismic analysis identified potentially large gas structures on trend with the previous discovery. In addition, several other prospects and leads exist on both blocks, including one which is adjacent to Lebada, Romania's only offshore oilfield.

Sterling operates a three-company study group investigating onshore oil opportunities in Romania. For decades the largest oil and gas producer in Eastern Europe, this country has significant rehabilitation and exploitation opportunities remaining in its producing oilfields. Negotiations have begun with Petrom, Romania's national oil company, to joint venture on these lands.

Wessex Basin, United Kingdom



In the United Kingdom, Sterling and its joint venture partners applied for three exploration blocks in the 8th Round of onshore licensing in October 1997. We were awarded all three in February 1998 under one license. Sterling has a participating interest of 45%.

The license covers an area of 66,000 acres in the Wessex Basin of southern England, approximately 15 kilometers from and on trend with Wytch Farm, the largest onshore oilfield in the United Kingdom. This field produces sweet 38° API oil.

Exploration on the license will target the same Jurassic and Triassic formations that produce at Wytch Farm and several smaller fields nearby. Sterling's entry into this area is consistent with our strategy and is a positive addition to our international portfolio.

Elsewhere, Sterling's international efforts are concentrated in selective countries in Europe, North Africa, and the Middle East where our plan is to acquire smaller working interests in larger plays.

Financial results for the year ended December 31, 1997 reflect Sterling's return to being an active oil and gas company.

With the change in year-end from October 31 to December 31, 1996, the financial statements are not comparable directly. However, comparisons for the fiscal year ended December 31, 1997 to the last full fiscal year ended October 31, 1996 indicate that revenue from oil and gas increased to \$338,097 from \$46,767, primarily as a result of Keho gas production starting in August. The increase in operating expense for 1997 reflects higher oil and gas production. Administrative expenses are higher due primarily to the cost of adding a base staff. Net loss for the year decreased to \$304,509 from \$403,743 for the year ended October 31, 1996.

With a full year's production from Keho in 1998, revenues will increase appreciably and both cash flow and net income should be positive.

AUDITORS' REPORT

To the Shareholders of Sterling Resources Ltd.

We have audited the balance sheet of Sterling Resources Ltd. as at December 31, 1997 and the statements of operations and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

The financial statements as at December 31, 1996 and October 31, 1996 and for the two months ended December 31, 1996 and the year ended October 31, 1996 were audited by other auditors who expressed an opinion without reservation on those statements in their reports dated February 5, 1997 and December 11, 1996 respectively.

Ernst & Young

Chartered Accountants

Calgary, Canada

February 26, 1998

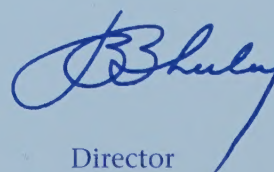
BALANCE SHEETS

December 31	1997	1996
ASSETS		
Current		
Cash and short term investments [note 3]	\$ 1,908,258	\$ 895,261
Accounts receivable	188,916	122,996
	<u>2,097,174</u>	<u>1,018,257</u>
Due from officer [note 2]	93,000	-
Site restoration trust fund [note 4]	54,280	-
	<u>147,280</u>	<u>-</u>
Fixed assets [note 5]		
Petroleum and natural gas properties and equipment	4,279,703	302,354
Furniture and fixtures	45,648	24,013
	<u>4,325,351</u>	<u>326,367</u>
	<u>\$ 6,569,805</u>	<u>\$ 1,344,624</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable	\$ 507,250	\$ 22,990
Provision for future site restoration	54,884	48,725
Shareholders' equity		
Share capital [note 7]	7,424,905	2,385,634
Deficit	(1,417,234)	(1,112,725)
	<u>6,007,671</u>	<u>1,272,909</u>
	<u>\$ 6,569,805</u>	<u>\$ 1,344,624</u>
<i>Commitments [note 8]</i>		
<i>See accompanying notes</i>		

On behalf of the Board:



Director



Director

STATEMENTS OF OPERATIONS AND DEFICIT

	Year ended December 31, 1997	Two months ended December 31, 1996	Year ended October 31, 1996
REVENUE			
Oil and gas, net of royalties	\$ 313,774	\$ 25,915	\$ 44,908
Gas processing	24,323	8,117	1,859
	<u>338,097</u>	<u>34,032</u>	<u>46,767</u>
EXPENSES			
Operating	161,964	(9,795)	33,899
General and administrative	432,026	47,840	253,209
Depletion, depreciation and amortization	180,112	32,772	223,457
	<u>774,102</u>	<u>70,817</u>	<u>510,565</u>
OTHER INCOME			
Interest	130,746	4,723	60,055
Gain on sale of fixed assets	750	—	—
	<u>131,496</u>	<u>4,723</u>	<u>60,055</u>
Net loss for the period	(304,509)	(32,062)	(403,743)
Deficit, beginning of period	(1,112,725)	(1,080,663)	(676,920)
Deficit, end of period	<u>\$(1,417,234)</u>	<u>\$(1,112,725)</u>	<u>\$(1,080,663)</u>
Loss per share	\$ (0.04)	\$ (0.01)	\$ (0.11)

See accompanying notes

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1997	Two months ended December 31, 1996	Year ended October 31, 1996
OPERATING ACTIVITIES			
Net loss for period	\$ (304,509)	\$ (32,062)	\$ (403,743)
Items not affecting cash			
Depletion, depreciation and amortization	180,112	32,772	223,457
Gain on disposal of fixed assets	(750)	-	-
	(125,147)	710	(180,286)
Change in non-cash working capital	149,186	(64,135)	(56,155)
Cash provided by (used in) operating activities	24,039	(63,425)	(236,441)
FINANCING ACTIVITIES			
Issue of common shares, net of issue costs	5,039,271	-	27,000
Loan to officer	(93,000)	-	-
Cash provided by financing activities	4,946,271	-	27,000
INVESTING ACTIVITIES			
Oil and natural gas properties and equipment additions	(4,144,573)	(8,795)	(112,871)
Furniture and fixture additions	(31,137)	(4,902)	(10,464)
Abandonment trust fund	(54,280)	-	-
Proceeds on disposal of assets	3,522	31,646	-
Change in non-cash working capital	269,155	-	-
Cash provided by (used in) investing activities	(3,957,313)	17,949	(123,335)
Increase (decrease) in cash	1,012,997	(45,476)	(332,776)
Cash and term investments, beginning of period	895,261	940,737	1,273,513
Cash and term investments, end of period	\$ 1,908,258	\$ 895,261	\$ 940,737

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

December 31, 1997

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Petroleum and natural gas properties and equipment

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs relating to the acquisition of, exploration for and development of petroleum and natural gas properties and equipment are capitalized in cost centres on a country-by-country basis. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals, costs of drilling and equipping productive and nonproductive wells and certain overhead expenditures related to exploration and development activities.

Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets except where such a disposal would alter the depletion and depreciation rate by more than 20 percent, in which case a gain or loss would be recognized.

Capitalized costs of proven petroleum and natural gas properties are depleted using the unit-of-production method based on estimated proven petroleum and natural gas reserves. For purposes of this calculation, these reserves are converted to a common unit of measure based on their relative energy content.

The net carrying value of the Company's oil and gas properties and equipment in each cost centre is limited to an estimated recoverable amount. This amount is calculated as the aggregate future net revenues from proved reserves plus the cost of unproved properties, net of impairment allowances, less future expenditures required to develop and produce the reserves and future site restoration costs. Future net revenues are calculated using prices in effect at the Company's year end without escalation or discounting.

The net carrying value of all developed cost centres, less related accumulated provisions for future site restoration costs and deferred income taxes, is further limited to the total estimated recoverable amount of all cost centres less future general and administrative costs, financing costs and income taxes.

Furniture and fixtures are carried at cost less accumulated depreciation. Depreciation is calculated on a declining balance basis at an annual rate of 20%.

(b) Future site restoration costs

Future site restoration and reclamation costs are accrued using the unit-of-production method. These costs are based on year-end estimates of the anticipated costs of site restoration.

During the year, \$6,159 of future site restoration costs were charged to expense (two months ended December 31, 1996 - \$5,385; year ended October 31, 1996 - \$7,970).

(c) Joint operations

Substantially all of the Company's exploration activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

(d) Loss per share

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. The effect of the exercise of outstanding stock options would be anti-dilutive.

(e) Measurement uncertainty

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and the provision for future site restoration and reclamation costs are based on estimates. The limitation on the carrying value of petroleum and natural gas properties is based on estimates of proved reserves, production rates and oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(f) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates.

2. RELATED PARTY TRANSACTIONS

During 1997, the Company loaned \$168,000 to an officer of the Company for purposes of acquiring common shares in the Company. During the year \$75,000 was repaid, resulting in a balance as at December 31, 1997 of \$93,000. The amount bears interest at 5%, payable monthly. The principle sum is payable on demand after December 31, 1999.

The Company has entered into a consulting agreement with a former officer and director of the Company whereby the Company has agreed to pay a monthly consulting fee of \$4,167. For the year ended December 31, 1997 consulting fees paid totaled \$50,000 (two months ended December 31, 1996 - \$8,333; year ended October 31, 1996- \$20,833). The agreement expires May 1998.

3. CASH AND SHORT TERM INVESTMENTS

Included in cash and short term investments are \$1,390,000 of bankers' acceptances (December 1996 - nil) with maturities of less than 90 days, bearing interest between 3.7% and 4.2%.

4. SITE RESTORATION TRUST FUND

This amount is held in trust by the Alberta Energy and Utilities Board. The fund is held as security against future restoration costs on certain Alberta properties. The fund earns interest at the prime business rate less administrative service charges.

5. FIXED ASSETS

a) Petroleum and natural gas properties and equipment

	1997	1996
December 31	\$	\$
Canadian oil and gas properties and equipment	3,391,360	1,395,498
Less accumulated depletion and depreciation	(1,260,368)	(1,093,144)
	2,130,992	302,354
Romanian oil and gas properties	2,073,718	-
U.K. oil and gas properties	74,993	-
	2,148,711	-
	4,279,703	302,354

Included in Canadian oil and gas properties and equipment are capitalized general and administrative costs of \$58,686 (1996 - \$nil).

The Romanian and U.K. cost centres are in the pre-development stage and as such the costs are not subject to depletion. Drilling activity in the Romanian cost centre has resulted in the discovery of non-commercial quantities of natural gas. The Company is planning follow-up drilling, however, such drilling is contingent on the extension of drilling licenses. Negotiations for these extensions are in progress with the Romanian government. The Company anticipates that the extensions will be provided. The recovery of the costs incurred to date is ultimately dependent upon discovering commercial quantities of hydrocarbons. The likelihood of such a discovery is not determinable at this time.

b) Furniture and fixtures

	1997	1996
December 31	\$	\$
Furniture and fixtures	54,047	26,618
Less accumulated depreciation	(8,399)	(2,605)
	45,648	24,013

6. INCOME TAXES

The provision for income taxes recorded on the financial statements differ from the amounts which would be obtained by applying the statutory income tax rate to the loss before income taxes as follows:

	1997	1996
December 31	\$	\$
Computed income taxes at the statutory rate of 44.62%	(135,900)	(14,300)
Non-deductible Crown charges	(8,600)	500
Resource allowance	29,000	-
Tax benefit of losses not recognized	115,500	13,800
	0	0

At December 31, 1997, the Company has the following balances available to be claimed against future income for tax purposes:

	\$
Undepreciated capital cost	398,000
Canadian development expenditures	823,000
Canadian oil and gas property expenditures	891,000
Canadian exploration expenditures	181,000
Unamortized share issue costs	282,000
Foreign exploration and development expenditures	1,916,000

In addition, as at December 31, 1997, the Company had the following non-capital losses available to reduce future Canadian taxable income.

	\$
1999	56,000
2000	405,000
2001	303,000
2002	356,000
2003	17,000
2004	856,000
Total	1,993,000

The benefit of these losses has not been recognized in these financial statements.

7. SHARE CAPITAL

a) Authorized

Unlimited common shares without nominal or par value

b) Issued

	Number of Shares #	Amount \$
Common shares		
Balance, October 31, 1996 and December 31, 1996	3,560,003	2,385,634
Exercise of stock options	50,000	15,000
Share offering	4,100,000	5,024,271
Balance, December 31, 1997	7,710,003	7,424,905

As at December 31, 1997 the Company has outstanding options to issue common shares to the following:

		Number of Shares #	Exercise Price Per Share \$
Directors and employee	May 23, 2001	166,667	0.42
Employee	September 18, 2001	10,000	0.48
Officer	November 15, 2001	150,000	0.56
Employees	December 20, 2001	135,000	0.56
Directors, officer and employees	December 18, 2002	255,000	0.90

During the year ended December 31, 1997 options for 255,000 common shares were granted.

During the year, the Company issued 3,450,000 units consisting of one common share and 0.9 transferable warrants per unit at a price of \$1.45 each. Each warrant entitles the holder to purchase one common share at a price of \$1.75 per share up to March 1, 1999. The proceeds, net of share issue costs of \$352,729, were \$4,649,771. As at December 31, 1997 all 3,105,000 warrants were outstanding.

During the year the Company also issued 500,000 common shares at \$0.56 and 150,000 shares at \$0.63 in two private placements to officers of the Company. Total proceeds to the Company were \$374,500.

8. COMMITMENTS

The Company is committed to an operating lease for office premises which expires February 28, 2000. Future payments are as follows:

	\$
1998	32,994
1999	32,994
2000	5,497

9. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

10. FINANCIAL INSTRUMENTS

The fair market values of the company's financial instruments, including cash and short term investments, accounts receivable, site restoration trust fund, and accounts payable, approximate their carrying value.

CORPORATE INFORMATION

DIRECTORS

Robert G. Welty
Chairman of the Board
and CEO
President, Escondido Resources
(International) Ltd.

Bruce W. Sherley
President

Raj K. Agrawal
President, NRG Engineering Ltd

J. Richard Harris
Independent Businessman

Philip C. Swift
Managing Director, ARC Financial Corp.

CORPORATE OFFICES

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Calgary, AB T2P 3S8

AUDITORS

Ernst & Young
1300, 707 - 7th Avenue S.W.
Calgary, AB T2P 3H6

REGISTRAR & TRANSFER AGENT

Montreal Trust
600, 530 - 8th Avenue S.W.
Calgary, AB T2P 3S8

ABBREVIATIONS

bbl	=	barrels
bbl/d	=	barrels of oil per day
Mbbl	=	thousands of barrels
MMbbl	=	millions of barrels
Mcf	=	thousand cubic feet
Mcf/d	=	thousand cubic feet per day
MMcf/d	=	million cubic feet per day
NGL	=	natural gas liquids

OFFICERS

Robert G. Welty
Chairman of the Board and
CEO

Bruce W. Sherley
President

Richard G. Willson
Vice-President Exploration

Rodger D. Conner
Corporate Secretary

Sherry L. Cremer
Treasurer and Assistant Controller

BANKER

The Royal Bank of Canada
Main Branch, 339 - 8th Avenue S.W.
Calgary, AB T2P 1C4

LEGAL COUNSEL

Conner & Conner
1515, 333 - 11th Avenue S.W.
Calgary, AB T2R 1T9

STOCK LISTING

Alberta Stock Exchange
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